

Mr Mike Buckley  
General Manager Network Regulation North  
Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601

Email: [aer inquiry@aer.gov.au](mailto:aer inquiry@aer.gov.au)

201 Elizabeth Street (cnr Park St)  
PO Box A1000 Sydney South  
New South Wales 1235 Australia  
Facsimile (02) 9284 3456  
Telephone (02) 9284 3000  
Web <http://www.transgrid.com.au>  
DX 1122 Sydney

Dear Mike

### **TransGrid's response to the submission by the Energy Users Association of Australia**

TransGrid appreciates the opportunity to respond to the Energy Users Association of Australia (EUAA) submission to the Australian Energy Regulator (AER) dated 15 August 2008 on TransGrid's Revenue Proposal 2009/10 – 2013/14.

This response includes references to the following documents:

- EUAA Submission to Australian Energy Regulator Review of TransGrid's Revenue Proposal for 2009/10 to 2013/14
- AER Draft Decision, TransGrid transmission determination 2009-10 to 2013-14
- TransGrid's Revenue Proposal dated 31 May 2008.
- TransGrid's revised Revenue Proposal dated 14 January 2009
- Minutes of the AER Pre-determination Conference for TransGrid and NSW transmission and distribution determinations, 9 December 2008

TransGrid would like to address the following specific matters raised by the EUAA:

1. Changes in the economic and business environment
2. Growth in demand and demand management
3. Regulatory asset base and capital expenditure
4. Operating expenditure
5. Impact on prices
6. Regulatory framework

#### **1. Changes in the economic and business environment**

The EUAA has raised concerns regarding the uncertainty stemming from the change in the economic and business environment due to the global financial crisis.

TransGrid notes the EUAA's concern regarding the impact of the global financial crisis and the effect this may have on the determination of the nominal risk free rate and the debt risk premium for the next regulatory period. TransGrid agrees that the unprecedented volatility experienced in the capital markets arising from the global financial crisis should be taken into account when determining the averaging period to ensure that it does not unduly affect long-term average returns to investors. TransGrid has addressed this in its revised Revenue Proposal.<sup>1</sup>

One of the major issues for TransGrid in the current economic climate, as for many businesses, is the cost of funding. The AER's decision with regard to TransGrid's rate of return for the regulatory control period

<sup>1</sup> TransGrid's revised Revenue Proposal 1 July 2009 – 30 June 2014, pages 51-62.

commencing July 2009 and the outcomes of the current AER review of the weighted average cost of capital (WACC) parameters on future regulatory control periods is of paramount importance in ensuring TransGrid is sufficiently compensated as contemplated by provisions in the National Electricity Law (NEL) and National Electricity Rules (NER).

TransGrid acknowledges the EUAA's view that an economic downturn will have a moderating effect on input costs during the 2009-14 regulatory period. Whilst forecasts<sup>2</sup> may indicate a decrease in commodity prices within the base currency of US dollars (USD), these costs need to be adjusted to account for depreciation in the Australian dollar relative to USD. Competition Economists Group (CEG) in its report on cost escalators, submitted as Appendix E of TransGrid's revised Revenue Proposal, has noted a non-forecast 25% depreciation in the Australian dollar between the original submission in April 2008 and the revised submission in January 2009.<sup>3</sup> There have been further declines in the exchange rate since this time.

Therefore in such an economic environment, TransGrid believes that its proposed forecast of required capex and opex reasonably reflects the efficient costs of a prudent operator in achieving the expenditure objectives of the NER. Further, the methodology adopted by TransGrid provides a realistic expectation of the future cost inputs required to achieve the capex and opex expenditure objectives. The AER has stated that the cost escalation factors will be updated closer to the time of the Final Determination.<sup>4</sup> TransGrid is of the view that this will ensure that these factors reflect the most up-to-date view of future input cost paths.

## 2. Growth in demand and demand management

The EUAA has raised concerns that the increase in TransGrid's proposed capex is excessive. TransGrid's ex ante expenditure needs have been expressly linked to meeting regulatory obligations. Whilst TransGrid endeavours to smooth its expenditure over time as much as possible, investment in transmission assets is "lumpy", based on the need to address capacity constraints as they arise within the various parts of the transmission network. Development of the transmission network and augmentation capital expenditure is driven by peak demand and the need to meet mandated reliability obligations, not by forecast energy as suggested by the EUAA.<sup>5</sup>

Significant expenditure on the NSW network was undertaken between the 1960s and the 1980s.<sup>6</sup> Since the 1980s, TransGrid has not needed to undertake as many transmission augmentations or large scale refurbishment of sites. Since the last major period of system augmentation, TransGrid has met the rising load growth in NSW and the increased interconnector flows through optimised operation and maintenance of the existing network. TransGrid has endeavoured to ensure that all efficiencies gained from the transmission system in NSW were realised to the benefit of the network users through appropriate timing of network augmentations. These efforts have helped to keep prices down for the benefit of customers.

The updated load forecasts used in support of TransGrid's Revenue Proposal were based on the NSW Annual Planning Report (APR) 2008 and were inclusive of carbon impact modelling. The AER engaged McLennan Magasanik Associates (MMA) to conduct a review of TransGrid's demand forecasting methodologies and processes. Based on MMA's advice, the AER accepted TransGrid's demand forecasts as providing a realistic expectation of demand based on economic forecasts that account for the effects of the global financial crisis.<sup>7</sup> TransGrid revised its capex programme and, consequently, its opex submission to align with the APR 2008 demand forecast<sup>8</sup> and this was the subject of the AER review.

The NSW distribution network service providers (DNSPs) have submitted updated load forecasts as part of their revised Revenue Proposals submitted in January 2009, which take into account current economic

<sup>2</sup> EUAA, Submission to Australian Energy Regulator Review of TransGrid's Revenue Proposal for 2009/10 to 2013/14, 15 August 2008, page 23

<sup>3</sup> TransGrid's revised Revenue Proposal 1 July 2009 – 30 June 2014, Appendix E

<sup>4</sup> AER, Draft Decision, TransGrid transmission determination 2009-10 to 2014-14, page 69

<sup>5</sup> EUAA, Submission to Australian Energy Regulator Review of TransGrid's Revenue Proposal for 2009/10 to 2013/14, 15 August 2008, page 13

<sup>6</sup> TransGrid's Revenue Proposal 1 July 2009 – 30 June 2014, Figure 5.10: Commissioning of new network assets, page 34

<sup>7</sup> AER, Draft Decision, TransGrid transmission determination 2009-10 to 2014-14, page 40

<sup>8</sup> TransGrid's revised Revenue Proposal 1 July 2009 – 30 June 2014, page 7

data and the impact of the Federal Government's Carbon Pollution Reduction Scheme. TransGrid is currently reviewing its capex programme in light of the updated DNSP demand forecasts. Initial indications are that no further reduction beyond that implemented by TransGrid in its updated capex proposal is possible. Confirmation of this is expected to be provided to the AER in late February.

Recent record demands in Victoria have highlighted the impacts that can be experienced by the community when significant electricity supply interruptions occur. It should be noted that TransGrid also experienced a record summer demand in early February 2009 which exceeded TransGrid's median demand forecast. TransGrid highlighted in its Revenue Proposal dated 31 May 2008 that as peak demands increase and high demand periods lengthen throughout the year, capital expenditure is required to avoid reduced reliability to customers<sup>9</sup>. This regulatory period marks the beginning of a period of increased capital expenditure for TransGrid to ensure that NSW's transmission infrastructure continues to meet customer expectations. TransGrid's proposed capital investments will satisfy load growth and peak demand forecasts and also maintain system security and reliability.

The EUAA have raised concerns that TransGrid has not adequately considered deferral options as part of the increased capital expenditure proposed. TransGrid adopts a multi-faceted approach to encouraging demand management (DM) and local generation options so as to reduce, defer or avoid the need for capital investment in its transmission network that would otherwise be necessary to meet its reliability obligations and meet the growing electricity demand in NSW.

Annual Planning Reports ensure that interested parties are kept informed several years in advance of emerging network constraints in NSW so that feasible DM and local generation options may be formulated to reduce the demand growth rate and therefore defer or avoid the need for new transmission network investment.

TransGrid has been actively seeking non-network alternatives to transmission augmentations in public documents since the National Electricity Market (NEM) commenced. TransGrid identifies, evaluates and performs a cost-benefit or least-cost analysis of each non-network alternative when considering options to alleviate emerging network constraints.

The regulatory test<sup>10</sup> provides an opportunity for input by all interested parties concerning proposed network augmentation and non-network solutions. TransGrid considers DM, local generation and bundled options on an equal footing with network options when applying the regulatory test. The EUAA and its members have an opportunity to participate in this process.

### **3. Regulatory asset base and capital expenditure**

The EUAA has raised a concern in regard to the variance in capital expenditure between the ACCC decision and the actual/forecast expenditure for the current regulatory period.

The application for the expenditure allowance was made five years ago and the expenditure occurred during a period of rising costs and increasing financial uncertainty. It is also important to note that the delay in the ACCC's 2005 revenue cap decision led to TransGrid's resources being diverted from planning and implementing projects, to responding to the review process. This impacted the timing of delivery of projects throughout the regulatory period, which resulted in an accelerated program in the last four years.

TransGrid considers the expenditure variance to the end of the 2004-09 regulatory period of \$57M or 4.3% to be within normal expectations given the factors outlined above. The AER and its consultants reviewed TransGrid's historical capex and found that it was reasonable.<sup>11</sup>

The EUAA has expressed concern that anticipatory costs for projects not approved under a revenue determination or a regulatory test could be inappropriately rolled into the asset base with additional charges incurred by customers in NSW. TransGrid does not include the cost of augmentation works in the

<sup>9</sup> TransGrid's Revenue Proposal 1 July 2009 – 30 June 2014, pages 28-29

<sup>10</sup> National Electricity Rules, Clause 5.6.5A. Further, Clause 5.6.6(b) requires TNSPs to consult on applications for new large transmission assets.

<sup>11</sup> AER, Draft Decision, TransGrid transmission determination 2009-10 to 2014-14, pages 22-25.



regulated asset base which have not passed the regulatory test, in accordance with the National Electricity Rules (NER).

The EUAA has stated that any asset replacement program should be based on a cost-benefit analysis to justify the trade-off with asset maintenance costs. However, this is only one driver for asset replacement. The main driver is the need to maintain ongoing reliability to customers through the prudent replacement of assets as they reach the end of their technical life. For the 2009-14 regulatory period, TransGrid has identified the need for asset replacements with a total expenditure of \$525.5M, an increase of 33% compared to the 2004-09 period. This program replaces some of TransGrid's oldest assets that are in poor condition and which pose an unacceptable risk to the achievement of regulatory obligations with regard to reliability, safety or the environment.

The EUAA claimed that TransGrid did not provide details explaining its asset management strategies or its asset performance review process<sup>12</sup>. This is incorrect. TransGrid's Network Management Plan 2009-14 is a publicly available document<sup>13</sup> that sets out TransGrid's asset management process and provides details of its asset management strategies for each asset category.

The EUAA has also raised concerns in regards to TransGrid's ability to deliver the capex programme, particularly if contingent projects are triggered. TransGrid has demonstrated its ability to deliver the capex programme submitted in its Revenue Proposal which, following a thorough review by its consultant, the AER has accepted. The AER concluded that TransGrid was "well positioned" to deliver the capex programme and that a negative impact from contingency projects is "highly unlikely" to occur.<sup>14</sup>

It should also be noted that it is not meaningful to add the proposed cost of the contingent projects to the forecast ex-ante expenditure. TransGrid prepares a list of contingent projects to accommodate the future and unforeseen needs of the NEM participants in NSW. It is highly unlikely that all contingent projects would be triggered in the next regulatory control period, and the most plausible scenario is that a small sub-set of these projects may be triggered. Triggers for contingent projects, which are outside of TransGrid's control, are well defined as is the process to initiate a contingent project. Generally, contingent projects produce a benefit to address a specific spot load or the market in general via interconnectors. In all cases, the expenditure is subject to further close review by the AER in accordance with the NER before it can be used as the basis for revenue cap adjustments.

#### 4. Operating expenditure

TransGrid has taken account of the impact of the capex programme on its forecast operating expenditure and has ensured that the forecast has been appropriately adjusted to reflect the reduced maintenance costs that result from lower maintenance required for new assets. However, TransGrid's revised Revenue Proposal clearly demonstrates that new assets do not come 'free' of opex obligations and this was supported by a review of opex maintenance by engineering consultants Sinclair Knight Merz (SKM)<sup>15</sup>. TransGrid's increased opex expenditure is driven by a number of factors including the growth of the asset base, the age profile of assets and the rising costs of labour inputs.

The EUAA provided a discussion on the expected age of the TransGrid network.<sup>16</sup> In its revised Revenue Proposal, TransGrid provided a trend of the age of different asset categories to the end of the next regulatory control period.<sup>17</sup> Overall, the system average age shows an increasing trend, as does the majority of asset types. The step change for substation assets in 2010 is associated with the high value 500kV assets coming on line, and is not reflective of TransGrid's asset replacement strategies. The protection workstream is the only asset class with a decreasing average age, reflective of the shorter lifespan of modern protection systems.

<sup>12</sup> EUAA, Submission to Australian Energy Regulator Review of TransGrid's Revenue Proposal for 2009/10 to 2013/14, 15 August 2008, page 16

<sup>13</sup> Available at TransGrid's website, [transgrid.com.au](http://transgrid.com.au)

<sup>14</sup> AER, Draft Decision, TransGrid transmission determination 2009-10 to 2014-14, page 85

<sup>15</sup> TransGrid's revised Revenue Proposal 1 July 2009 – 30 June 2014, Appendix L

<sup>16</sup> EUAA, Submission to Australian Energy Regulator Review of TransGrid's Revenue Proposal for 2009/10 to 2013/14,

15 August 2008, page 17

<sup>17</sup> TransGrid's revised Revenue Proposal 1 July 2009 – 30 June 2014, Figure 5.2, page 70



The EUAA noted in its submission that TransGrid's selected base year for opex efficiency, 2006/07, had higher actual operating costs than the costs reported for 2007/08 and 2008/09 by 3.6% and 3% respectively. The audited 2006/07 results represent the base year costs from which all 'non business as usual' and other one-off costs have been deducted.

The lower costs in 2007/08 and 2008/09 were mainly as a result of a one-off "holiday" for superannuation contributions, meaning TransGrid was not required to contribute to certain employee superannuation schemes. Under normal business circumstances, these superannuation contribution holidays are not anticipated to reoccur. It is further noted that, with the global financial crisis, it is expected that significant superannuation contributions will be required by TransGrid in the future.

## 5. Impact on prices

TransGrid recognises and appreciates the EUAA's concern about energy price increases for electricity users in NSW. However, the EUAA must recognise that the cost increases are the direct result of ensuring a safe and reliable supply to customers and fulfilling our service obligations.

TransGrid's Revenue Proposal addresses the needs of transmission users in NSW by providing a reliable transmission system and minimising constraints to the electricity market. TransGrid's capex and opex forecasts take into consideration the increasing energy needs of consumers and allow the network to be developed to facilitate connection of alternative forms of low carbon emission generation.

The emphasis of the NEL is not on price per se, but on meeting the National Electricity Objective which is "to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to-

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system."

With this in mind, the Rules require the revenue caps to be determined on the basis of efficient costs required to meet defined objectives. They also require the AER to have regard for a wide range of factors beyond short term price impacts.

TransGrid's proposal has undergone extensive review by the AER and its consultants, Parsons Brinckerhoff Australia Pty Ltd. TransGrid is confident that its proposal represents a reasonable and realistic estimate of the efficient costs to develop and maintain the transmission network in NSW to support continuing economic growth in the state.

TransGrid noted in its revised Revenue Proposal that the transmission cost represented approximately 6% of the delivered price for the average energy user. TransGrid believes a modest increase of approximately \$4.90 per annum for a typical household<sup>18</sup> means that NSW and ACT end users will still benefit from the lowest cost transmission service in Australia.

The EUAA raised a concern about year to year price shocks that may affect members. At the Pre-determination conference held on 9 December 2008, TransGrid stated that customers have been the beneficiaries over a number of years of the discounts that flowed from the market trading residues being used to offset transmission costs. While these residues have reduced in 2008/09, due to the abolition of the Snowy Region and the expectation of new generation coming on line in NSW, customers continue to receive a benefit from these residues and are not fully exposed to the transmission prices in the NEM. The volatility in pricing has also been impacted by two pass through events that occurred in the current regulatory period and which, under the NER, must be recovered in the period they are incurred.<sup>19</sup>

<sup>18</sup> TransGrid's revised Revenue Proposal 1 July 2009 – 30 June 2014, page 100

<sup>19</sup> Minutes of the AER Pre-determination conference for TransGrid and NSW transmission and distribution determinations, 9 December 2008, page 7

## 6. Regulatory framework

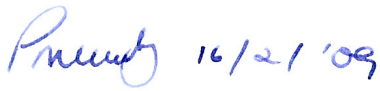
The EUAA has also raised concerns around the application of the NER, including:

- exemptions to service standards for capital work should not be allowed
- a need for rules to protect end-users from inflated transmission prices due to potential overspending of capex allowances by TNSPs under the ex-ante arrangements
- that cost pass through rules need to be more tightly drafted and controlled

These issues should be handled through the Rule change process, not as part of a submission regarding a Revenue Proposal. TransGrid supports the consultation processes in place for any changes to the NER and would encourage the EUAA to raise their concerns via that process.

If you have any queries in relation to this submission please contact Mr John Howland on (02) 9284 3509.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'P. McIntyre', followed by the date '16/2/09'.

Peter McIntyre  
General Manager/Network Development and Regulatory Affairs